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SIPDIS

DEPT FOR AF/S/JDIFFILY; AF/EPS; EB/IFD/OMA
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E.O. 12958: N/A
TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER
February 4 2005 ISSUE

¶1. Summary. Each week, AMEmbassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:
- Background to the February 9 Monetary Policy Committee Meeting;
- Trade Conditions Weakened in January;
- Money Supply and Credit Growth Remains High;
- Manufacturing Survey Declines;
- January Vehicle Sales Increase 20.9 Percent;
- Vehicle Parts Sector Shows Weakness;
- Draft Immigration Bill Increases Regulations;
- First Black Appointed as Anglo American's Chief Executive;
- December's Trade Balance Surplus; Yearly Trade Deficit;
- Retail Sector Receives 8.8 Percent Wage Increase; and -
- Deregulation of Telecommunications Sector Starts.
End Summary.

BACKGROUND TO THE FEBRUARY 9 MONETARY POLICY COMMITTEE MEETING
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¶2. Comment. On February 9-10, the Monetary Policy Committee meets to decide the direction of interest rates for the next two months. Most analysts predict that the Committee will decide to leave interest rates unchanged; however, the following five articles highlight short-term, conflicting economic trends describing the current state of the South African economy, making predictions about next week's interest rate decision difficult. The second Monetary Policy Committee meeting in 2005 is scheduled for April 13 and 14. End Comment.

TRADE CONDITIONS WEAKENED IN JANUARY

¶3. The South African Trade Management Indices weakened in January, with the trade activity index below 50, implying a contraction in trading activity. Seasonally adjusted, the trade activity index reached 48, compared to December's value of 50. January is the third consecutive month showing gradual weakening of the trade activity index. The trade expectations index (TEI), measuring expectations of trade conditions for the next six months, indicates that medium-term sales expectations should improve. The TEI increased to 63 compared to December's 60, with expectations regarding sales volumes, new orders and purchase prices being especially strong. The converging trend of the two activity measures offers more conflicting evidence on the future expansion of the South African economy. Source: Standard Bank, SATMI, February ¶3.

MONEY SUPPLY AND CREDIT GROWTH REMAINS HIGH

¶4. In December, money supply growth (M3) grew 12.8 percent (y/y), slowing somewhat, although growth in private sector credit extension (PSCE) accelerated, reaching 13.6 percent. The accelerating growth of private sector credit extension, reflecting strong consumer demand, may be a major factor influencing the Monetary Policy Committee. Over the past three months, PSCE has shown healthy growth at 10.2 percent, 10.4 percent and 13.6 percent, for October through December 2004. In December, credit for installment sales, mortgage advances and leasing finance experienced growth of over 15 percent, at 21.2, 24.1 and 15.6 percent respectively, while credit for investment and discounted bills declined. December's growth in PSCE was largely driven by private sector credit demand components and underlying consumer demand, especially in durable goods. These fourth quarter 2004 trends are expected to fuel growth in 2005. In 2004, growth in consumption has been financed largely by credit, which has led to concerns about the sustainability of the current economic expansion. However, reductions in

financing costs have allowed the debt to income ratio (55.4 percent in 2004 Q3) to remain relatively low. Source: Standard Bank, Money Supply Alert and Investec Money Supply Alert, January 31; Business Day, February 1.

¶5. Comment. CPIX inflation (consumer inflation excluding mortgage costs) slowed to 4.3 percent y/y in December, below the midpoint of the 3-6 percent inflation target band, helped by the strong rand. Based on inflation figures alone, additional rate reductions could be expected; however, trends in private sector credit demand reduce the chances of additional rate cuts. Recent statements by Tito Mboweni, the South African Reserve Bank's (SARB) Governor, highlight continuing inflation concerns. The Governor says that the SARB wanted a competitive exchange rate "which brings about a proper balance in the earnings of exporters, but also contributes significantly to low inflation from the import side of the equation." End Comment.

MANUFACTURING SURVEY DECLINES

¶6. In January, the Purchasing Managers' Index (PMI), a leading indicator of manufacturing output, showed signs of weakening, falling to 49.3, the first time below 50 in 15 months, compared to December's value of 53.2. A value below 50 indicates that more managers are experiencing worsening business conditions than those expecting improvement. The PMI also indicated a January pause in growth of consumer demand, with the subindex measuring new sales orders dropping to 49.7 compared to December's 57. Strong domestic consumer demand is not offsetting the effects of the strong rand and weak global demand on the manufacturing sector. Statistics SA recently released November's manufacturing production, showing a monthly 1.2 percent decline, also indicating a slowdown in manufacturing production. In 2004, the rand appreciated 18 percent against the dollar, leading to South Africa's 2003 trade surplus of R16 billion turning to 2004's trade deficit of R12.5 billion. In 2003, the manufacturing sector accounting for 16 percent of GDP, contributed more than half of South Africa's exports. Source: Business Day and Business Report, February 2.

JANUARY VEHICLE SALES INCREASE 20.9 PERCENT

¶7. Motor vehicle sales grew by 20.9 percent in January (y/y), with passenger cars showing growth of 22.2 percent, according to statistics released by the National Association of Automobile Manufacturers of South Africa (NAAMSA). In January, the top five passenger car manufacturers include: (1) Volkswagen at 19.1 percent market share; (2) Toyota having 18.4 percent share; (3) DaimlerChrysler with 16.7 percent share; (4) General Motors SA with 9 percent share; and (5) Ford Motor Company with 7.5 percent share. Sales of commercial vehicles showed strong January growth at 35.6 percent, leading to expectations that 2005 motor sector's growth will remain robust. The car market is expected to continue growth next year. At worst, interest rates should remain unchanged, given December's CPIX inflation of 4.3 percent, allowing consumers to continue to finance asset purchases through debt. NAAMSA reports that real vehicle prices declined by 3.5 percent in December, another reason for expecting continuing strong market conditions. Source: Standard Bank, Motor Alert, February 2.

VEHICLE PARTS SECTOR SHOWS WEAKNESS

¶8. According to Clive Williams, executive director of the National Association of Automotive Components and Allied Manufacturers, the vehicle component sector is facing increased prospects of production cuts. The strong rand is cutting into profit margins on exports and keeping domestic prices low while imported component prices continue to decline. According to Williams, small parts companies that had been building up distribution networks in the United States over the past five years are abandoning their export programs and only large companies, with economies of scale, are able to still export. Local car manufacturers are limiting component price increases, as imports provide competitive pressure on prices. Vehicle and parts exports to the U.S. were valued at $150 million in 2000, $359 million in 2001, $572.9 million in 2002; however in November 2004, exports to the U.S. declined 23.2 percent (on a year-to-date basis), reaching $530.3 million. Car manufacturers have announced recent plans to increase South African investment, with both Volkswagen planning to increase its exports from South Africa by 45 percent and Toyota planning to increase its South African exports from 10,000 to 100,000 by 2010. Source: Business Day, February 2.

DRAFT IMMIGRATION BILL INCREASES REGULATION

¶9. Draft immigration regulations, issued by the Home Affairs Department and published for comment, appear significantly stricter than earlier proposals, and suggest a deliberate effort to tighten up immigration procedures. The business permit for entrepreneurs wishing to start businesses in South Africa now asks potential investors to meet more requirements. In the past they had to meet at least just two out of seven requirements before being granted approval. Now they have to comply with all seven requirements. In addition to having to provide R2.5 million ($420,000) in financial guarantees, the main criterion in the past, would-be investors would now have to supply proof of a business plan. The business plan would outline its feasibility both in the short and long term, show proof of entrepreneurial skill, demonstrate that they would permanently employ at least five citizens or five permanent residents, provide proof of the export potential of the business, and include a police-clearance certificate. Linda Lamprecht, an immigration expert at PricewaterhouseCoopers, stated that the criteria would affect small and medium business operations most. She also stated that the requirement of requiring potential investors to contribute to the geographical spread of economic activity, would also have negative effects. The Department of Home Affairs defended the new regulations, saying they would contribute towards the development of an immigration policy framework that responded to both the "developmental and socioeconomic needs of our country, the continent and the world." Sourcee: Business Day, February 1.

FIRST BLACK APPOINTED AS ANGLO AMERICAN'S CHIEF EXECUTIVE
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¶10. Larazus Zim takes over South African operations at Anglo American and becomes the first black appointed as a chief executive officer at Anglo American. Tony Trahar, the previous chief executive for South African operations, will remain chief executive of London-listed Anglo American and chairman of the South African operations. According to Trahar, South Africa remained the largest portion of Anglo's portfolio, contributing 35 percent of its profits. Zim was appointed Trahar's deputy in 2003, working primarily with the company's South African operations and placing importance on cooperation between business and government. Source: Business Report and Business Day, February 1.

DECEMBER'S TRADE BALANCE SURPLUS; YEARLY TRADE BALANCE DEFICIT
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¶11. For the month of December, the trade balance showed a small surplus at R2.8 billion; although for the year, it showed a R12.5 billion deficit, below the 2003 surplus of R16.1 billion. December's trade surplus followed six months of consecutive monthly trade deficits. Exports increased 2.5 percent on a monthly basis, rising to R28.6 billion, while imports declined by 9.2 percent (m/m) reaching R25.8 billion, despite evidence of strong consumer demand in December. December's base metals and mineral products increased while exports of vehicles and aircraft as well as machinery declined. Imports of machinery, plastics, original components, chemicals and metals declined compared to November's export values. For the year as a whole, exports increased by 7 percent while imports increased by 18.6 percent. In 2004, South Africa's trade deficit has been easily financed by capital inflows. In 2005, trade deficits may continue due to continuing strength of the rand and weakening global demand. In 2005, Standard Bank expects world growth at 3.8 percent, with advanced economies growing at 2.5 percent and emerging country growth at 5.2 percent, slower than 2004 growth rates. Source: Standard Bank, Foreign Trade Alert, January 31.

RETAIL SECTOR RECEIVES 8.8 PERCENT INCREASE

¶12. The Department of Labor announced an 8.8 percent wage increase, starting February 1, for workers in the retail and wholesale trade sector. This increase is above the inflation target of 3-6 percent, but necessary to narrow income gaps between black and white wage earners. Source: Business Report, February 1.

DEREGULATION OF TELECOMMUNICATION STARTS

¶13. As of February 1, 2005, the first step towards deregulation of the telecommunications sector has begun. Value-added network service (VANS) providers can now offer voice services (VoIP), provide their own fixed infrastructure, acquire infrastructure from other licensed

operators other than Telkom, the telephone parastatal, and resell spare capacity, as can other private telecommunication network (PTN) operators. Much of the industry believes that private operators will soon be able to offer a variety of services and technologies previously monopolized by Telkom. This would lead to rapid competition on voice calls, internet access, video conferencing and high speed data transmissions. Regulations drawn up by Independent Communications Authority of South Africa (ICASA) propose a license application fee of R30,000 ($5,000 using 6 rands per dollar), a 600 percent hike from the current fee of R5,000. ICASA also wants every Vans operator to be 30 percent owned by black shareholders by October 2005. Both Telkom and Vodacom have argued the Telecommunications Act does not allow VANS operators to provide their own facilities. This means that such operators must continue leasing their networks from Telkom, or from the cellular operators. Source: Business Day, February 1.

FRAZER